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CHARLES ELMORE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 338

DAVID H. JENNINGS, Receiver of the National Bank of America, and NATIONAL BANK OF AMERICA, Petitioners,

vs.

UNITED STATES FIDELITY AND GUARANTY COMPANY, Respondent.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit and Brief in Support Thereof.

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Supreme Court of the United States

OCTOBER TERM, 1934.

No. ——

DAVID H. JENNINGS, Receiver of the National Bank of America, and NATIONAL BANK OF AMERICA, Petitioners,

vs.

UNITED STATES FIDELITY AND GUARANTY COMPANY, Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

To the Honorable Charles Evans Hughes, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States.

Your petitioners respectfully show:

I.

SUMMARY OF MATTERS INVOLVED.

Nature of Action.

This is a suit in equity brought by the United States Fidelity and Guaranty Company, respondent, in the Circuit

Court of Lake County, Indiana, against the National Bank of America of Gary, Indiana, and David H. Jennings, Receiver of the National Bank of America, to recover $2,196.89 and to have the same declared a preferential claim, that being the amount of a check which had been mailed to and collected by the National Bank of America through the Gary Clearing House before the National Bank of America closed. On petition of Mr. Jennings, as Receiver, the cause was removed to the District Court of the United States for the Northern District of Indiana, Hammond Division (Rec. 5 to 10).

The Facts.

The respondent on the 30th day of December, 1931, received from the Commercial Trust Company of Gary, Indiana, a check payable to its order for $2,196.89 drawn by said Trust Company on The Gary State Bank of Gary, Indiana. On December 30th, 1931, it deposited said check with the Security Trust Company of Indianapolis, Indiana, for collection. The Security Trust Company on the same day deposited said check with the Fletcher American National Bank of Indianapolis for collection, and the last named bank on the same day forwarded said check to the National Bank of America for collection and remittance. The National Bank of America received said check on the morning of December 31st, 1931, and in the forenoon of that day presented it to the drawee bank through the clearing house for collection. There was at that time an organization in Gary known as the Clearing House Association, the sole and only members of said Association at that time being the National Bank of America, The First National Bank, and The Gary State Bank (Rec. 21, 22). It was the custom for the representatives of said banks to meet at ten A. M. on each day and exchange checks received by the member banks before nine thirty A. M. When the clearings were against any bank, it was the custom for such bank to pay such difference to the clearing house by drafts drawn upon its cor-

respondent bank. Prior to nine thirty A. M. of December 31st, 1931, the National Bank of America received from the Fletcher Bank for collection checks drawn on other banks in Gary aggregating $3,661.33, including said check for $2,196.89, and all of said checks were on said day presented by said National Bank of America through the clearing house for exchange and clearance.

When the representatives of the several banks met at the clearing house to exchange checks, the National Bank of America had and presented checks, drawn on The Gary State Bank aggregating $8,095.56, including the said check for $2,196.89. It also had and presented checks drawn on the First National Bank in the sum of $2,329.89, while the other banks held checks drawn on the National Bank of America in the sum of $11,470.19. As a result of the clearings and the exchange of checks on said day, the National Bank of America was indebted to and owed the other banks $1,044.75 for which it drew its draft on the Continental Illinois Bank and Trust Company of Chicago, Illinois, payable to the order of the clearing house (Rec. 22, 23).

After having thus made the collection, the National Bank of America drew and mailed to the Fletcher American Bank its draft on the Continental Illinois Bank and Trust Company for $3,660.83, that being the amount of the proceeds of the checks that day received from the Fletcher American National Bank and so collected through the clearing house. When said last named draft was drawn, the National Bank of America had on deposit with the Continental Illinois Bank and Trust Company an amount in excess of the amount named in said draft (Rec. 24). This draft failed to clear before the National Bank of America failed and for that reason was not paid. At the time the National Bank of America failed, it had on deposit with the Fletcher American National Bank the sum of $3,994.75. On January 5th, 1932, the Fletcher American National Bank charged the account of the National Bank of America with the amount of said draft and later paid the balance of

$333.91 to said receiver and thereafter on demand of the said receiver, it paid him the sum of $3,660.83 and charged the account of the Security Trust Company with the sum of $2,196.89 and the Security Trust Company in turn charged the account of the United States Fidelity and Guaranty Company with the same amount (Rec. 23, 24, 25).

On December 31st, 1931, and for more than two years prior thereto, there was in force in the State of Indiana a statute known as the Uniform Bank Collection Code (Indiana Acts 1929, page 514), the material parts of which statute are set out in the Appendix to the petitioners' brief in support of this petition.

The facts in this cause were stipulated and were adopted by the District Court as its special findings of facts, upon which the court concluded as a matter of law that the cash items of the National Bank of America became impressed with a trust in the sum of $2,196.89 at the time said check was collected; that the petitioner David H. Jennings, as receiver, took said sum impressed with the trust; that respondent was entitled to recover said sum of $2,196.89 with interest thereon in preference to the general creditors of the National Bank of America and judgment was entered in accordance with the conclusions of law. (Rec. 30, 31.)

The receiver of the suspended bank and the bank appealed to the Circuit Court of Appeals, where the judgment of the District Court was reversed as to the item of interest (R. p. 54) and in all other respects affirmed (R. p. 9), and the petitioners seek a review of the decree of the Circuit Court of Appeals holding respondent was entitled to have its claim allowed as preferred.

II.

REASONS RELIED ON FOR ALLOWANCE OF THE WRIT.

The facts having been stipulated, the petitioners complain of the decree, based upon the conclusions of law, wherein it was held:

(1) That there was an augmentation of the funds and assets of the collecting bank when the clearings of the day were against the collecting bank and when the collection item was used for the purpose of paying and taking up checks drawn on the collecting bank.

(2) That when a national bank doing business in Indiana collects, through a clearing house, a check drawn on another bank, when the only thing the collecting bank receives through such collection are checks drawn on itself, there is augmentation of the funds of the collecting bank, and tracing of the proceeds of such collection into the possession of such receiver though the difference in the clearings is against the collecting bank.

(3) That under the Indiana Bank Collection Code, when a collection is made by a national bank in that state through a clearing house, the difference in the clearings being against the bank and when the collection item is used to take up and pay checks drawn on the collecting bank, the funds and assets of the collecting bank are augmented.

Petitioners believe that the writ of certiorari should be granted because:

(a) The decision and decree of the Circuit Court of Appeals involves a federal question relating to the rights of creditors against insolvent national banks under the National Banking Laws and the decision of the Circuit Court of Appeals appears to be in conflict with the principles of law established in analogous cases by this Honorable Court in:

Pottorff v. Texas & Pacific Railroad, 291 U. S. 245, 261 (note 19).
Blakey v. Brinson, 286 U. S. 254, 262.
Schuyler v. Littlefield, 232 U. S. 707, 710, 713.
Cunningham, Trustee, vs. Brown, 265 U. S. 1, 11.
St. Louis & San Francisco R. R. v. Spiller, 274 U. S. 304, 310.
Davis v. Elmira Sav. Bank, 161 U. S. 275.

(b) The decision of the Circuit Court of Appeals is in conflict with the principles of law established by the decisions of the Circuit Courts of Appeal in analogous cases in other circuits, namely:

Second Circuit:
American Can Co. v. Williams, 178 F. 420.

Fourth Circuit:
Ellerbe v. Studebaker Corp., 21 F. (2) 993, 995.

Sixth Circuit:
Brennan v. Tillinghast, 201 F. 609, 612, 613.

Eighth Circuit:
Larabee Flour Mills v. First National Bank, 13 F. (2) 330, 331, cert. den. 273 U. S. 727.
Beard v. Independent District of Pella City, 88 F. 375, 382, 383.
Empire State Surety Co. v. Carroll County, 194 F. 593, 604, 605, 606.
Hirning v. Federal Reserve Bank, 52 F. (2) 382.
Farmers National Bank v. Pribble, 15 F. (2) 175, 176.
Cuttell v. Fluent, 51 F. (2) 974, 976.
Dickson v. First National Bank, 26 F. (2) 411, 412.
Roebeck v. Benedict Flour & Feed Co., 26 F. (2) 440, 441.

Ninth Circuit:
Titlow v. McCormick, 236 F. 209, 211, 212.
Schilling v. Rowe, 64 F. (2) 188, 190.

Tenth Circuit:
Blumenfield v. Union National Bank, 38 F. (2) 455, 457.
Spokane County v. First National Bank, 68 F. 979, 982.

The foregoing cases in the various circuits, and the decisions of this Honorable Court, above cited, establish the principles of law that a preferred claim can be allowed against the estate of an insolvent only where (1) the transaction with the preferred claimant resulted in augmenta-

tion or increase of the assets of the insolvent by the property of the claimant or the proceeds thereof in the form of actual cash or other tangible assets (as distinguished from the establishment and appropriation or dissipation of a deposit or book credit) and (2) that such property or assets of the preferred claimant, or other property identified as being in lieu thereof, can be traced into the hands of the receiver or trustee taking over the assets of the insolvent at the time of suspension or bankruptcy, and (3) that the burden of showing the facts of augmentation and tracing is upon the preferred claimant and that the law will not presume augmentation and tracing. Assuming such principles of law to be controlling in the establishment of preferred claims, it would appear that the decision of the Circuit Court of Appeals is clearly contrary to such principles for the reasons that augmentation and tracing did not exist in the instant case, and the court was in error in its construction of the principles of law relating to augmentation and tracing and also in holding, as a matter of law, that a preferred claim existed regardless of augmentation.

The decision of the Circuit Court of Appeals in the instant case appears to be in conflict, in principle, with its two recent decisions in the cases of Allied Mills, Inc. v. Horton, 65 Fed. (2nd) 708 and Connolly v. Lang, 68 Fed. (2nd) 199.

The decision of the Circuit Court of Appeals in the instant case holding that augmentation and tracing appear where the proceeds of an item held in trust are dissipated through use in a clearings transaction on a day when the balance was against the now insolvent National Bank, is in direct conflict with the decision of the United States Circuit Court of Appeals, Eighth Circuit in Farmers National Bank v. Pribble, cited above, and the cases cited therein.

(c) The Circuit Court of Appeals has decided an important question of general law relating to the liquidation of insolvent national banks, in a way probably untenable and in conflict with the weight of authority indicated by the foregoing decisions.

(d) The precise kind of case decided by the Circuit Court of Appeals has not, apparently, heretofore been passed upon by this Court. The decision of the Circuit Court of Appeals in this case is the first case holding that the Uniform Bank Collection Code applies in the liquidation of an insolvent national bank being liquidated by a receiver and holding that under such statutes, collections made by a national bank are impressed with a trust and that the receivers of such banks holds the assets of such banks in trust without proof of actual augmentation and tracing of the funds.

Eighteen states have adopted the Uniform Bank Collection Code and it is quite important in the liquidation of insolvent national banks that the questions involved in this appeal should be decided by this court so as to furnish an authoritative decision as to whether the funds of a bank are augmented when a collection is made through a clearing house in a state which has adopted a Uniform Collection Code, when the items collected are used to pay an obligation to the clearing house.

(e) The decision and holding of the Circuit Court of Appeals as to the augmentation of the assets of a national bank and the tracing of the proceeds of a collection into the possession of the receiver thereafter appointed for the collecting bank, by holding and deciding that when a national bank doing business in Indiana collects, through a clearing house, a check drawn on another bank, when the only thing the collecting bank receives through such collection are checks drawn on itself, there is an augmentation of the funds of the collecting bank, and a tracing of the proceeds of said collection into the possession of said receiver, though the difference in the clearings is against the collecting bank, on the ground and for the reason that the collecting bank is instantly relieved from the obligation on the checks drawn on itself which it receives in exchange for the checks held for collection and is the equivalent of the substitution

of cash and cash items held by the bank to the extent of the item or check collected, is a decision of a federal question in a way probably in conflict with the decisions of this Honorable Court, and the question of law involved is of great importance to the business world and the legal profession and calls for an authoritative and elucidating decision of this court as to the effect of collections made by a national bank through a clearing house in a state which has adopted the Uniform Bank Collection Code.

WHEREFORE your petitioners pray that a writ of certiorari be issued under the seal of this court directed to the Circuit Court of Appeals for the Seventh Circuit commanding said court to certify and send to this court a full and complete transcript of the record and of the proceedings of said Circuit Court of Appeals, had in the case numbered and titled on the docket as No. 5124, National Bank of America, Appellants v. United States Fidelity and Guaranty Company, Appellee, to the end that this cause may be reviewed and determined by this court and that the decree herein of said Circuit Court of Appeals be reversed by this court and for such further relief as to this court may seem proper.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934.

No. ——

DAVID H. JENNINGS, Receiver of the National Bank of America, and NATIONAL BANK OF AMERICA, Petitioners

vs.

UNITED STATES FIDELITY AND GUARANTY COMPANY, Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

OPINION OF COURTS BELOW.

The opinion of the District Court is set out in the Record at pp. 27 to 30 and is reported in 4 Federal Supp. 569. The opinion of the Circuit Court of Appeals for the Seventh Circuit, not yet reported, is found in the record at pp. 46 to 54.

II.

JURISDICTION.

The decree of the Circuit Court of Appeals sought to be reviewed was entered June 4, 1934 (R. 55). Jurisdiction is conferred upon this court to review this cause by writ of certiorari under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925. (U. S. C. Title 28, Section 347.)

This action was commenced by the United States Fidelity and Guaranty Company against the appellants, David H. Jennings, Receiver of the National Bank of America, and the National Bank of America, a banking corporation, organized under the provisions of the National Bank Act and which on January 2nd, 1932, and for many years prior thereto, was engaged in the banking business in the city of Gary, Lake county, Indiana. It is a suit in equity and relates to the winding up of the affairs of an insolvent national bank commenced and brought against an officer, and agent of the United States, namely: David H. Jennings, Receiver of the National Bank of America, and is an action arising under the laws of the United States of America.

III.

STATEMENT OF THE CASE.

A statement of the case is set out in the foregoing petition under the caption, "Summary of Matters Involved," to which reference is here made. Such elaboration of the facts as appears to be pertinent and necessary to the discussion will be indicated where appropriate.

IV.

SPECIFICATION OF ERRORS.

1. The Circuit Court of Appeals erred in holding and deciding that under and by virtue of the act of the General

Assembly of the State of Indiana entitled "An Act to expedite and simplify the collection and payment by banks of checks and other instruments for the payment of money," Approved March 13, 1929, David H. Jennings, as Receiver of the National Bank of America, holds the proceeds of the collection of the check for $2,196.89 in trust and that the same should be paid by him to the United States Fidelity and Guaranty Company in preference to the creditors of said insolvent bank.

2. The court erred in holding and deciding that when a national bank doing business in Indiana receives a check from another bank for collection and remittance, and makes the collection through a clearing house at a time when the difference in the clearings is against the collecting bank, the cash and cash items of the collecting bank are thereby augmented although the check is used in paying the obligation of the collecting bank to the clearing house.

3. The court erred in holding and deciding that when the National Bank of America "exchanged appellee's (United States Fidelity and Guaranty Company's) check on The Gary State Bank for checks which the latter held against the former at the clearing house transaction, appellee's check by virtue of Section 9 of the Indiana Act, was not used to pay the appellant's debt to the clearing house, but was a collection of the check in a manner authorized by the Act; hence that which it received is to be considered as proceeds of the check" and "that the legal effect of the transaction was a substitution of cash and cash items held by appellant bank to the extent of $2,196.89 for the checks upon itself which it received as agent in payment of appellee's check", and by virtue of such transaction "there was augmentation of the cash and cash items to the extent of the proceeds of appellee's check, toward which appellant bank remained a fiduciary." (R. 51, 52.)

4. The Circuit Court of Appeals erred in holding and deciding that "as between the clearing house and appellant

bank, the latter's checks as a matter of commercial convenience were considered rightfully paid under the Indiana law, but as between the bank and appellee, they were not paid by the bank unless it be considered that a corresponding amount of cash was substituted for the unpaid checks."

5. The Circuit Court of Appeals erred in not reversing the trial court's issuance of an injunction restraining the Receiver from using so much of the cash and cash items in his possession as needed to satisfy the judgment and decree appealed from. (R. 31 and 34.)

V.

SUMMARY OF ARGUMENT.

Point 1.

In the liquidation of an insolvent national bank by a receiver appointed by the Comptroller of the Currency the provisions of the *National Bank Act, Section 5236,* U. S. R. S. (12 U. S. C. Ch. 2 Sec. 194) and the decisions of the Federal Courts control and require a pro rata distribution of the assets among all creditors. National banks are instruments designed to be used to aid the government. They are a part of the government's financial system, and their operation and liquidation cannot be controlled by state legislation. The affairs of insolvent national banks in Indiana, as well as elsewhere, are wound up under the National Bank Act as in a code by itself, and the provisions of the Bank Collection Code of Indiana, providing for preferential claims, have no application to insolvent national banks which are being liquidated through a receiver.

Point 2.

A claimant who seeks a preference must establish the fact that the fund from which he seeks payment is his property or the proceeds of his property, or that his property went into it and remains in a mass from which it cannot be

distinguished. Equity will pursue a fund and impose upon it the character of a trust only upon the theory that the money is still the property of the claimant.

Point 3.

It is indispensable to the maintenance of a claim to preferential payment of a receiver of a national bank, that the proof clearly shows that the property which the claimant seeks to recover was impressed with a trust, and that it or its proceeds went into a specific fund or into a specific identified piece of property that came into the hands of the receiver, and also that the value of the general assets of the insolvent bank which came into the possession of the receiver were increased thereby. When a check is collected and paid through a clearing house, the balance of the clearings being against the collecting bank, and the check is used in paying a balance due the clearing house from the collecting bank, the funds in the hands of a receiver of the collecting bank have not been augmented and a claim for preference must fail.

Point 4.

Section 13, subsection 3 of the Indiana Bank Collection Code in so far as it relates to failed or closed national banks, by providing that when such a bank has made a collection and has failed or been closed, the assets of such collecting bank shall be impressed with a trust and that the owner of the item collected shall be entitled to a preferred claim irrespective of whether the funds, representing the item collected can be traced and identified as a part of the assets of the insolvent bank, is an attempt to control and regulate the liquidation of an insolvent national bank in a way which conflicts with the provisions of the *National Bank Act, Section 5236 U. S. R. S.* (12 U. S. C. Ch. 2, Sec. 194) and to that extent is void.

Point 5.

The jurisdiction of the courts is limited to the determination of the validity of a claim of the character here asserted with a direction to the Receiver to certify the claim to the Comptroller of the Currency for payment in due course of administration under the following authorities:

Eastern Township Bank v. Vermont Nat. Bank (C. C.), 22 Fed. 186, 189;
Hallett v. Fish (C. C.), 123 Fed. 201, 203;
Merrill v. First National Bank (C. C. A. 5), 75 Fed. 148, 153;
Richardson v. Louisville Banking Co. (C. C. A. 5), 94 Fed. 442, 449.

The statute (Sec. 194, Title 12, U. S. C. A.) permits claims against insolvent national banks to be proved to the satisfaction of the Comptroller of the Currency or to be adjudicated by a court of competent jurisdiction. Only where a claim, found valid by a court of competent jurisdiction, is certified to the Comptroller of the Currency for payment in due course of administration is there an assurance that the rights of all others similarly situated, who may have proved their claims to the satisfaction of the Comptroller, or in another court, will be protected in the event it is necessary to prorate a given fund between a number of preferred claimants. It was error for the trial court to enjoin the bank Receiver from disposing of the cash that passed into his hands in the manner provided in the National Bank Act (Sec. 192, Title 12, U. S. C. A.) and to direct the Receiver to pay a certain sum forthwith, and this error, properly presented to the Appellate Court, should have been noted and the trial court reversed as was done incident to the erroneous allowance of interest subsequent to suspension. (R. 54.)

ARGUMENT.

Proposition 1.

The National Bank Act and the decisions of the federal courts control in the distribution of the assets of an insolvent national bank. The general rule is that distribution of the assets of a national bank must be made in accordance with *Section 5236 U. S. R. S.* (12 U. S. C. Ch. 2, Sec. 194), which requires a *pro rata* distribution among all creditors.

Of the numerous cases so holding, we cite the following:

Cook County National Bank v. United States, 107 U. S. 445, 448, 27 L. Ed. 537, 538, 539;
Davis v. Elmira Savings Bank, 161 U. S. 275, 284, 286, 40 L. Ed. 700;
Easton v. Iowa, 188 U. S. 220, 229, 47 L. Ed. 452, 456;
First National Bank v. Colby, 88 U. S. 609, 612, 22 L. Ed. 687, 688;
Oates v. National Bank, 100 U. S. 239, 246, 25 L. Ed. 580, 583.

The Controlling Statute.

12 U. S. C. Ch. 2, Sec. 194 is as follows:

> "From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated."

In *Cook County National Bank v. United States*, 107 U. S. 445, 448, 27 L. Ed. 537, 538, the court speaking of the National Bank Act, said:

> "We consider that Act as constituting by itself a complete system for the establishment and government

> of national banks, prescribing the manner in which they may be formed; . . . their liability to be placed in the hands of a receiver, and the manner, in such event, in which their affairs shall be wound up, their circulating notes redeemed and other debts paid or their property applied towards such payment. Everything essential to the formation of the banks, the issue, security and redemption of their notes, the winding up of the institutions and the distribution of their effects, are fully provided for, as in a separate code by itself."

And in the same opinion, the court after quoting the provisions of Section 5236 U. S. R. S. relating to refunding to the United States any deficiency in redeeming the circulating notes of such associations and directing the payment of ratable dividends by the Comptroller on page 450 said:

> "This section provides for the distribution of the entire assets of the bank, giving no preference to any claim except for moneys to reimburse the United States for advance in redeeming the notes."

Davis v. Elmira Savings Bank, 161 U. S. 275, 284, 286, 40 L. Ed. 700, 701, 702; *First National Bank v. Colby*, 88 U. S. 609, 612, 22 L. Ed. 687, 688, are to the same effect.

The issues in the instant case should be determined by resorting to principles of general commercial law, as defined by the federal courts, independent of the state law on the subject.

Easton v. Iowa, 188 U. S. 220, 229, 47 L. Ed. 452, 456;
Farmers & M. National Bank v. Dearing, 91 U. S. 29, 34, 23 L. Ed. 196, 199;
First National Bank v. Selden (C. C. A. 7), 120 F. 212, 215;
Fiman v. State of South Dakota (C. C. A. 8), 29 F. (2) 776;

In *Easton v. Iowa*, 188 U. S. 220, 229, 47 L. Ed. 452, 456, the court, in discussing the nature of national banks and federal legislation creating and regulating them, said:

> "That legislation has in view the erection of a system extending throughout the country and independent so far as powers conferred are concerned, of state legislation which, if permitted to be applicable, might impose limitations and restrictions as various and numerous as the states."

To the same effect see *Farmers & M. National Bank v. Dearing*, 91 U. S. 29, 34, 23 L. Ed. 196, 199.

A state law may be applied to a solvent national bank but not to an insolvent bank in the hands of a Federal receiver. In *First National Bank v. Selden* (C. C. A. 7), 120 F. 212, 215, the court in discussing the application of a state law to an insolvent national bank being liquidated by a receiver, said:

> "Now, while it may be questioned, whether as against the Niles bank, solvent, the Illinois bank might not, as to the payment of check and draft holders, act under the Illinois law as against the law prevailing in federal courts; . . . it is clear that as against the receiver, executing his trust, the federal law alone is applicable. The moment the Niles bank went into the hands of the receiver, the federal law became the law of the distribution of its assets. In no other way could there be unity of administration, and a carrying out of the federal mandate of equality."

To the same effect see *Fiman v. State of South Dakota* (C. C. A. 8), 29 F. (2) 776, 777.

Proposition II.

The adjudicated cases upon the subject of preferred claims have laid down the following prerequisites to the establishment of a preferred claim against an insolvent na-

tional bank: First, the funds claimed must be impressed with a trust. Second, the assets of the bank must have been increased or augmented by the transaction in which the fund was involved. Third, the claimant must be able to trace the fund into the hands of the receiver and there identify same.

American Can Co. v. Williams (C. C. A. 2), 178 Fed. 420-423.
Ellerbe v. Studebaker Corp. (C. C. A. 4), 21 Fed. (2nd) 993-995.
Swan v. Childrens Home Society (C. C. A. 4), 67 Fed. (2nd) 84; Certiorari denied 290 U. S. 704.
City of Miami v. First National Bank (C. C. A. 5), 69 Fed. (2nd) 346.
Keyes v. Pudacah & Illinois Railroad (C. C. A. 6), 61 Fed. (2nd) 611.
Brennan v. Tillinghast (C. C. A. 6), 201 Fed. 609.
Board of Commrs. v. Strawn (C. C. A. 6), 157 Fed. 49-54.
Macy v. Roedenbeck (C. C. A. 8), 227 Fed. 346, 353, 356.
Larabee Flour Mills v. First Nat. Bank (C. C. A. 8), 13 Fed. (2nd) 330-331, Certiorari denied 273 U. S. 727.
Hirning v. Federal Reserve Bank (C. C. A. 8), 52 Fed. (2nd) 382.
Beard v. Independent Dist. (C. C. A. 8), 88 Fed. 375.

Proposition III.

IN RE AUGMENTATION.

In Collections Through Clearing House, There is No Augmentation When the Clearing is Against the Collecting Bank.

Where a collection item is paid through a clearing house, and the balance of the clearings is against the collecting bank, the assets of the bank are not increased for the obvious reason that it receives no actual money on account

of the collection item, but uses the check to pay items in the clearings drawn on it.

The rules relating to augmentation and tracing of the funds of an insolvent national bank are admirably stated in *Empire State Surety Co. v. Carroll County*, 194 F. 593, where the court said:

> "This is a suit in equity against the receiver of a national bank to require him to take from the ratable dividends of other creditors of the bank the requisite amount to pay the county's claim in full. The receiver must make the distribution of the property of this bank in accordance with the provisions of the national banking law. It is the dominant purpose and requirement of that law that, after provision for a redemption of its notes is made, the proceeds of an insolvent national bank shall be equally distributed among its unsecured creditors. So imperative is this provision that it repeals a former act of Congress giving a preference to the United States and annuls a statute of a state giving a preference to deposits of savings bank. *Rev. St. sec. 5236* (U. S. Comp. St. 1901, p. 3508); *Davis v. Elmira Savings Bank*, 161 U. S. 275, 285, 16 Sup. Ct. 502, 40 L. Ed. 700. *National Bank v. Colby*, 21 Wall. 609, 613, 614, 22 L. Ed. 687. The burden, therefore, is on the sureties to prove clearly that they are entitled on equitable principles to the preference they seek. They proved that the bank took the deposits of the county and of its other depositors in trust for them respectively. But this was not enough. They were also required to prove that these deposits or their proceeds, or a certain part of them, came to the hands of the receiver, for he is liable to *cestuis que trustent* to pay trust funds in full only to the extent that he receives them.
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> "It is indispensable to the maintenance by a *cestui que trust* of a claim to preferential payment by a receiver out of the proceeds of the estate of an insolvent that clear proof be made that the trust property or its

proceeds went into a specific fund or into a specific identified piece of property which came to the hands of the receiver, and then the claim can be sustained to that fund or property only and only to the extent that the trust property or its proceeds went into it. *It is not sufficient to prove that the trust property or its proceeds went into the general assets of the insolvent estate and increased the amount and the value thereof which came to the hands of the receiver.* (Our italics.)

* * * * * * * * *

"In this state of the proof the fact is established, and its existence is not contradicted by any evidence, that the Farmers Bank never obtained or received any of the cash in this $6,368.66 from or on account of the plaintiff's draft for $1,046.89. On the other hand, it expended $115.13 to make the clearance by means of which it used this draft to pay some of the checks and drafts which the People's Bank had against it. . . . The result is that the only effect of the use of the draft of $1,046.89 in the clearance and transaction of May 10, 1924, was not in any way to increase the assets of the Farmers Bank, but possibly, perhaps probably, to diminish its indebtedness or liability by the amount of the draft, and such a reduction of its indebtedness creates no preferential trust in or lien on the assets of the insolvent over the claims of its general creditors.

"But checks of third persons on the bank with which they are deposited which are paid by crediting the bank and charging the drawers on its books fail to increase the cash in its possession and form no basis for a preferential payment to the depositor. *Beard v. Independent District of Pella City,* 88 F. 375, 382, 31 C. C. A. 562.

"Moreover, the deposit of checks of third persons which are credited to the depositor and used by the bank to pay its debts bring no money into its fund of cash and form no foundation for preferential payment to the depositor. *City Bank v. Blackmore,* 75 F. 771, 773, 21 C. C. A. 514.

"Again, checks of third parties deposited with a bank credited to the depositor and collected through a clearing house lay no foundation for a preferential

> payment, in the absence of proof of the actual balance of cash the bank received on account of them, for they may have been and usually are used in whole or in part to discharge the debts of the bank."

To the same effect see, *Cuttell v. Fluent*, 51 F. (2) 975, 976; *Lowell v. Brown*, 284 F. 936, 941; *Blumenfield v. Union National Bank*, 38 F. (2) 455, 457.

The doctrine that a claimed sum may be recovered as a trust fund if it can be traced into the general balance of the assets over liabilities of an insolvent estate has been pronounced an "exploded notion."

> *State Bank of Winfield v. Alva Security Bank*, 232 F. 947;
> *Dudley v. Richards*, 18 F. (2) 876, 878.

Proposition IV.

Section 13, Subsection 3 of the Indiana Bank Collection Code in so far as the same undertakes to provide that the assets of the agent collecting National Bank which has failed shall be impressed with a trust in favor of the owner of the item collected irrespective of whether the funds representing the item collected can be traced and identified as a part of the assets of such failed bank, is in conflict with *Section 5236 U. S. R. S.* (12 U. S. C. Ch. 2, Section 194) and the Indiana Statutes is to that extent void.

To quote from the court's opinion in the leading case on the subject, that of *Davis v. Elmira Savings Bank*, 161 U. S. 275-284:

> "We have, therefore, on the one hand, the statute of the United States, directing that the assets of an insolvent national bank shall be distributed by the Comptroller of the Currency in the manner therein pointed out, that is, ratably among the creditors. We have on the other hand, the statute of the State of New York giving a contrary command. To hold that the state statute is operative is to decide that it overrides the

plain text of the act of Congress. This results, not only from the fact that the two statutes, as we have said, cover the same subject-matter, and relate to the same duty, but also because there is an absolute repugnancy between their provisions, that is between the ratable distribution, commanded by Congress, and the preferential distribution directed by the law of the State of New York.

"The conflict between the spirit and purpose of the two statutes is as pronounced as that which exists between their unambiguous letter. It cannot be doubted that one of the objects of the national bank system was to secure, in the event of insolvency, a just and equal distribution of the assets of national banks among all unsecured creditors, and to prevent such banks from creating preferences in contemplation of insolvency. This public aim in favor of all the citizens of every State of the Union is manifested by the entire context of the national bank act."

One of the most elucidating decisions upon this question is *Prigg vs. Pennsylvania*, 16 Pet. 539, 618 from which we quote: "For if Congress have a constitutional power to regulate a particular subject, and they do actually regulate it in a given manner, and in a certain form, it cannot be that the state legislatures have a right to interfere, and, as it were, by way of complement to the legislation of Congress, to prescribe additional regulations, and what they may deem auxiliary provisions for the same purpose. In such a case, the legislation of Congress in what it does prescribe, manifestly indicated, that it does not intend that there shall be any further legislation to act upon the subject matter. Its silence as to what it does not do is as expressive of what its intention is as the direct provisions made by it."

Proposition V.

This proposition is discussed under Point 5, "Summary of Argument," on page 15 of this brief.

CONCLUSION.

The petitioners believe that the decision of the Circuit Court of Appeals is contrary to the principles of law established in the Circuits other than the Seventh Circuit and to the principles as established by the decisions of this honorable court. The petitioners in the interest of uniformity in the administration of the liquidation of National Banks throughout all of the Circuits and in the interest of settling conclusively the law upon the issues involved submit that their petition for a writ of certiorari should be granted.

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APPENDIX.

Pertinent Sections of the Indiana Bank Collection Code.

An Act to expedite and simplify the collection and payment by banks of checks and other instruments for the payment of money.

Approved March 13, 1929. Indiana Acts 1929, p. 514.

"Section 1. *Be it enacted by the general assembly of the State of Indiana,* That for the purpose of this code:

(a) The term 'bank' shall include any person, firm or corporation engaged in the business of receiving and paying deposits of money within this state. A branch or office or any such bank shall be deemed a bank for the purpose of this act.

(b) The term 'item' means any check, note or other instrument providing for the payment of money."

"Section 2. Except as otherwise provided by agreement and except as to subsequent holders of negotiable instrument payable to bearer or indorsed specially or in blank, where any item is deposited or received for collection, the bank of deposit shall be agent of the depositor for its collection and each subsequent collecting bank shall be subagent of the depositor but shall be authorized to follow the instructions of its immediate forwarding bank and any credit given by any such agent or subagent bank therefor shall be revocable until such time as the proceeds are received in actual money or an unconditional credit given on the books of another bank, which such agent has requested or accepted. Where any such bank allows any revocable credit for an item to be withdrawn, such agency relation shall nevertheless continue except the bank shall have all the rights of an owner thereof against prior and subsequent parties to the extent of the amount withdrawn."

"Section 9. Where ordinary care is exercised, any agent collecting bank may receive in payment of an item without becoming responsible as debtor therefor, whether presented by mail, through the clearing house or over the counter of the drawee or payor, in lieu of money, either (a) the check or draft of the drawee or payor upon another bank or (b)

the check or draft of any other bank upon any bank other than the drawee or payor of the item or (c) such method of settlement as may be customary in a local clearing house or between clearing banks or otherwise: *Provided,* That whenever such agent collecting bank shall request or accept in payment an unconditional credit which has been given to it on the books of the drawee or payor or on the books of any other bank, such agent collecting bank shall become debtor for such item and shall be responsible therefor as if the proceeds were actually received by it in money."

"Section 13. (3) Where an agent collecting bank other than the drawee or payor shall fail or be closed for business as above, after having received in any form the proceeds of an item or items entrusted to it for collection, but without such item or items having been paid or remitted for by it either in money or by an unconditional credit given on its books or on the books of any other bank which has been requested or accepted so as to constitute such failed collecting or other bank debtor therefor, the assets of such agent collecting bank which has failed or been closed for business as above shall be impressed with a trust in favor of the owner or owners of such item or items for the amount of such proceeds and such owner or owners shall be entitled to a preferred claim upon such assets, irrespective of whether the fund representing such item or items can be traced and identified as part of such assets or has been intermingled with or converted into other assets of such failed bank."

"Section 15. In any case not provided for in this act the rules of law and equity, including the law merchant and those rules of law and equity relating to trusts, agency, negotiable instruments and banking, shall continue to apply."